

Appendix B: Funding Mechanics and Budget Scoring

This appendix explains the more detailed TIFIA funding mechanics and accounting for the TIFIA credit instruments. This appendix also briefly describes DOT's capital allocation model, which is designed to estimate the subsidy amount for an individual TIFIA credit instrument.

Funding Mechanics

Chapter 2 summarizes the “dual controls” on TIFIA funding; Congress limits not only the maximum annual credit assistance amounts, but also the annual spending on TIFIA subsidy costs, or “budget authority.” To understand the TIFIA funding mechanics, it is useful to examine the Federal Credit Reform Act (FCRA), terminology for the TIFIA program, and the flow of funds for the TIFIA credit instruments.

Background on the Federal Credit Reform Act of 1990

Since enactment of the FCRA in 1990, federal agencies have been required to set aside capital reserves in advance to cover the expected long-term cost to the Government of issuing a direct loan, line of credit, or loan guarantee. This reserve is often called the “subsidy cost,” “budget score,” or “credit reform score.”

Prior to the FCRA, loan costs were recognized in the federal budget on a cash basis. This generated numerous distortions in the annual budget process. The cost of direct loans was overstated while the cost of loan guarantees was understated. Direct loans required budget authority for the full loan amount in the year the loans were made, while subsequent loan repayments were counted as receipts in future budget years. Loan guarantees were extended with no immediate budget impact, but upon default by the borrower, the Government was required to provide the funding to cover the guarantee.

The FCRA was enacted to address these problems. The purposes of the FCRA are to: (i) measure the costs of federal credit programs more accurately; (ii) place the cost of credit programs on a budgetary basis equivalent to other federal spending; (iii) encourage the use of credit assistance in the form most appropriate to the needs of recipients; and (iv) improve the allocation of resources among credit programs and between credit and other spending programs.

The OMB's Role

The Office of Management and Budget (OMB) is responsible for overseeing the implementation of credit reform. In this role, OMB reviews and approves all TIFIA credit subsidy cost estimates. Information on budgeting for federal credit programs is included in OMB Circulars A-11 and A-34, and information on accounting for federal credit is included in OMB Circular A-34 and the Statement of Federal Financial Accounting Standards (SFFAS) accounting standards #2.

Subsidy Cost Estimates, Re-estimates, and Modifications

A cornerstone of credit reform is the subsidy cost estimate, which is the estimated long-term cost to the Government of a direct loan, loan guarantee, or line of credit, calculated on a net present value basis, excluding administrative expenses. For the TIFIA program, the subsidy cost generally represents the present value of the Government's expected credit losses.

The form of credit does not, in itself, materially affect the subsidy cost. Rather, the risk profile of the individual project, coupled with particulars of the financing structure, will determine the subsidy cost.

The TIFIA authorizes subsidy budget authority of \$80 million in fiscal year 1999; \$90 million in fiscal year 2000; \$110 million in fiscal year 2001; \$120 million in fiscal year 2002; and \$130 million in fiscal year 2003. This subsidy budget authority is subject to annual obligation limitations that may be established in appropriations law. Of the amounts made available, the Secretary may use up to \$2 million in each of the fiscal years for administrative expenses. Unobligated budget authority remains available for obligation in subsequent years.

The nominal amount of federal credit assistance that may be disbursed in the form of direct loans and loan guarantees is the amount at origination. For standby lines of credit, the nominal amount is the principal amount of potential draws (direct loans) that may be funded during the period of availability. Total annual federal credit assistance authorized under the TIFIA program is limited to \$1.6 billion in fiscal year 1999; \$1.8 billion in fiscal year 2000; \$2.2 billion in fiscal year 2001; \$2.4 billion in fiscal year 2002; and \$2.6 billion in fiscal year 2003. These amounts are no longer available if not awarded by the end of the fiscal year for which they were provided.

Re-estimates measure the changes in the subsidy amounts that occur over time. As part of its ongoing portfolio monitoring, the DOT is statutorily required to annually adjust the original subsidy cost estimates. A re-estimate results when a subsidy cost is adjusted upward or downward. If a specific Government action (by Congress or an agency) alters the estimated subsidy cost of the loan, it is called a modification. If the action increases the subsidy cost of the credit instrument, budget authority must be set aside to cover the increased cost.

Program and Financing Accounts

The budget authority that is required to fund the subsidy costs and the administrative expenses associated with the TIFIA program is remitted to the Program Account. Administrative expenses can be obligated directly from the Program Account or transferred to a Salaries and Expenses Account for expenditure. The subsidy amount for a particular TIFIA credit instrument is eventually transferred from the Program Account to the Financing Account. The Financing Account is the account from which all funds are disbursed and all repayments are collected. All cash flows related to a TIFIA credit instrument will flow through the Financing Account.

Flow of Funds for TIFIA Credit Instruments

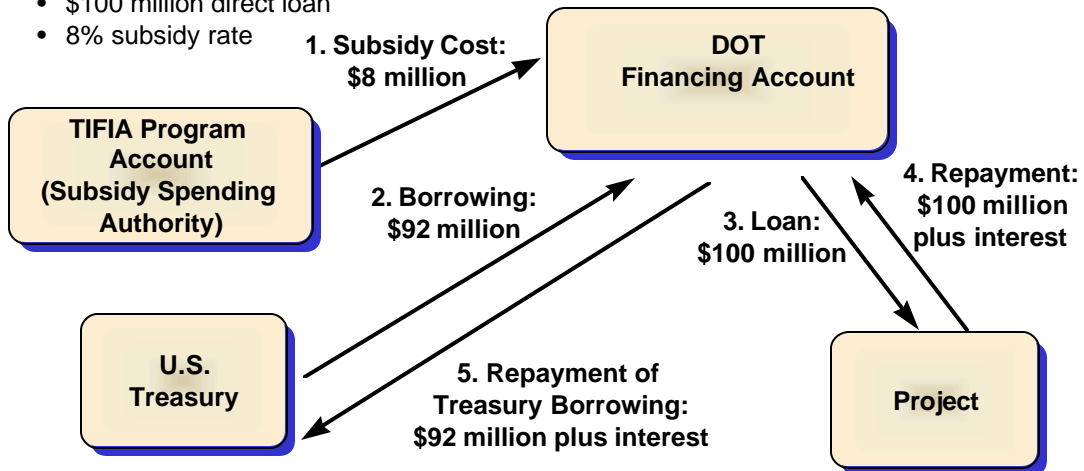
The flow of funds for the various TIFIA credit instruments is illustrated in the following diagrams. As shown below in Exhibit B-1, for direct loans and lines of credit the Financing Account receives the subsidy spending authority from the Program Account; borrows the unsubsidized portion of the loan from Treasury; disburses the loans to borrowers; collects repayments, interest, and fees (if any); and repays its borrowing to Treasury, plus interest. If a loan is fully repaid, the subsidy amount deposited in the Financing Account is transferred to the Treasury General Fund. (These funds are not retained by the DOT.)

Note that for all TIFIA credit instruments, the DOT obligates budget authority to cover the subsidy estimate on the day that the DOT issues the term sheet, not on the day that the project sponsor actually draws down funds.

Exhibit B-1: Illustration of Funding for Direct Loans and Lines of Credit

EXAMPLE:

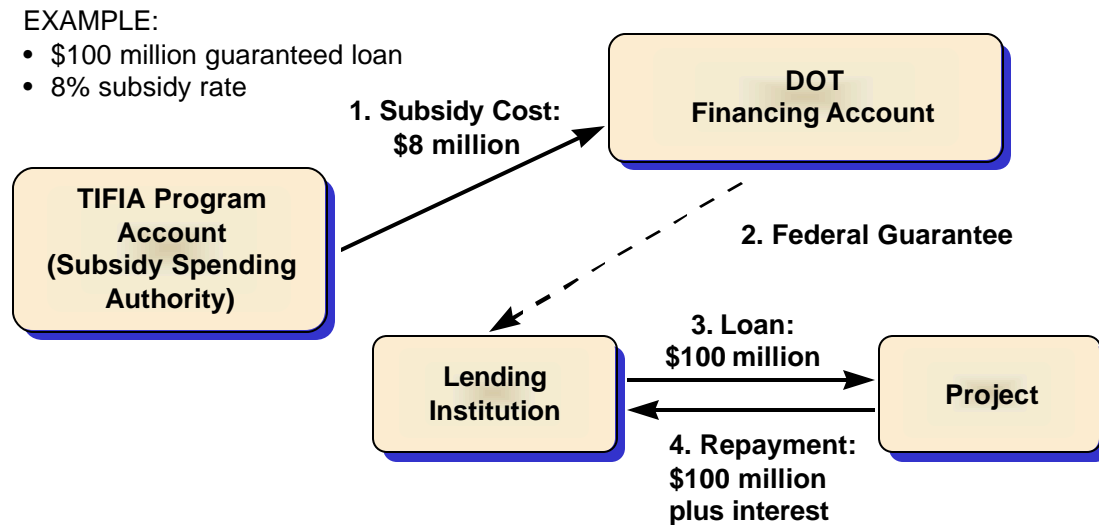
- \$100 million direct loan
- 8% subsidy rate



As shown in Exhibit B-2, for loan guarantees, the Financing Account receives the subsidy from the Program Account; collects fees from borrowers (if any); acts as a reserve for default claims; receives interest on reserves from Treasury; and pays default claims. The project sponsor pays principal and interest to the lending institution according to the terms of the loan agreement.

Subsidy reserves for outstanding TIFIA loan guarantees are held in the interest-bearing Financing Account. If the project sponsor defaults, the reserves are used to make claim payments to the lending institution. If the subsidy estimates for all of the loans in a TIFIA program cohort were accurate, the Financing Account would have the exact amount of reserves needed to cover all defaults and other subsidies for that cohort of loans.

Exhibit B-2: Illustration of Funding for Guaranteed Loans*



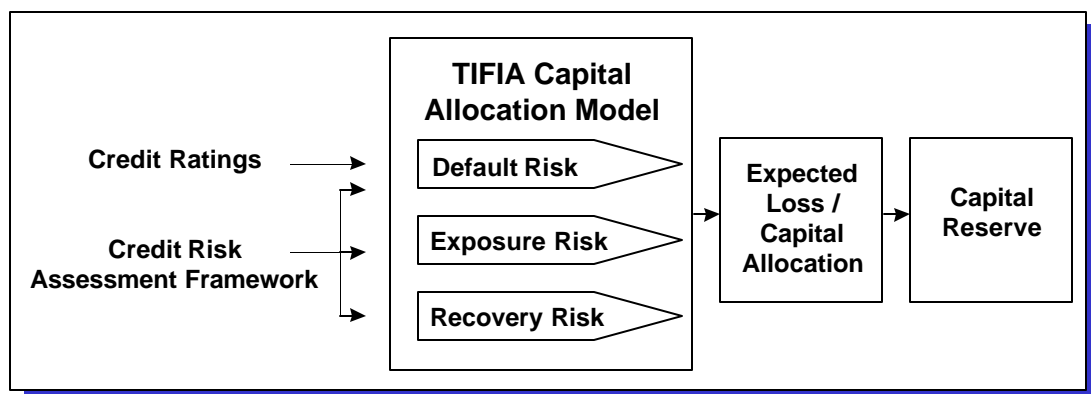
* Diagram assumes subsidy reserves in financing account are sufficient to cover all losses.

Credit Risk Assessment Framework: The TIFIA Capital Allocation Model

The DOT, drawing upon the expertise of the rating agencies and financial consultants, has developed a framework for assessing the risk associated with TIFIA credit instruments – direct loans, lines of credit, and loan guarantees.

Similar to other federal subsidy cost models, the approach for estimating TIFIA subsidy costs relies upon a discounted cash flow model (See Exhibit B-3). The subsidy cost of a TIFIA credit instrument can be estimated in a five-step process:

1. Identify the requested TIFIA credit instrument terms and conditions.
2. Estimate default risk by obtaining a credit opinion on the Government's default risk from one or more of the nationally recognized credit rating agencies.
3. Use the historical default experience for like-rated corporate bonds as a conservative proxy for the TIFIA instrument's expected default risk.
4. Estimate recoveries in the event of a default based on Standard & Poor's Bond Insurer Capital Adequacy Model.
5. Discount projected cash flows at the rate on Treasury securities of comparable maturity to the point(s) of disbursement using the OMB Subsidy Model.

Exhibit B-3: Illustration of the TIFIA Capital Allocation Model

Estimating TIFIA Subsidy Costs

The DOT has developed a “quick score” cost estimation model, which is available to project sponsors via the TIFIA web site (<http://tifia.fhwa.dot.gov>). The model will generate a preliminary (ballpark) estimate of the subsidy cost likely to be assigned to a project, given certain financial factors such as loan size, loan terms, and credit ratings.